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UNITED STATES
DEPARTMENT OF THE INTERIOR

REVIEW OF
FEDERAL
COAL LEASING



WASHINGTON, D.C.

March 19, 1984

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THE SECRETARY OF THE INTERIOR
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March 19, 1984

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Honorable George Bush
President of the Senate
Washington, D.C. 20510

Dear Mr. President:

The Department of the Interior submits to the Congress its comments on the report and recommendations of the Commission on Fair Market Value For Federal Coal Leasing. This letter transmits not only the Department's comments but also its proposed plans for operation of the Federal Coal Management Program. These plans were developed as a result of my independent review of the Department's past policies and procedures, and my review of the recommendations of the Commission.

Under the Mineral Lands Leasing Act of 1920, the Department of the Interior has responsibility for leasing Federal coal lands. However, until 1960, there was little demand for Federal coal and thus little leasing activity. In the 1960s leasing increased substantially. In 1971, a moratorium was imposed by the Department on the leasing of coal lands, based on a belief lands were being leased primarily for speculation rather than for development.

The 1971 moratorium, originally intended for a short period, was terminated in July 1979 when the Department issued regulations implementing the Federal Coal Leasing Amendments Act of 1976.

Leasing was not resumed until January 1981. Between then and September 1983, 14 regional coal lease sales were held. These sales were deemed necessary to further national security by reducing energy dependence, and to provide consumers with coal at competitive prices.

In response to questions raised concerning program procedures, the Congress established the Commission on Fair Market Value Policy on July 30, 1983. The Commission was instructed to review and recommend procedures to ensure receipt of fair market value for Federal coal leases. On November 4, 1983, Congress imposed a moratorium on coal lease sales to remain in effect for 90 days following submission of the Commission's report to Congress. The report was submitted to Congress and provided to the Department on February 17, 1984.

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In November 1983, when I assumed office at Interior, a review of aspects of the coal leasing program was already underway. After examinations of Departmental records and the Commission's report, I have concluded two distinct issues must be considered:

1. Programmatic issues involving coal leasing procedures to determine whether coal leasing should occur, to calculate the amount of coal which should be leased, and to conduct sales;
2. Conduct of individual employees in specific lease sales, and the adequacy of Departmental review of their conduct.

In my judgment, each of these issues required a separate and independent review.

To address programmatic issues, I convened a working group from within the Department composed of employees not directly involved with coal leasing programs during the period in question. This group has reported directly to a Deputy Under Secretary under the supervision of the Under Secretary. In addition to its review function, this group was given an added responsibility for assisting in my continuing study of the coal leasing program. This review and formulation of current proposals for improved procedures have been completed.

I further asked the Deputy Under Secretary to review all questionable conduct by individual DOI employees including questionable investigations of such conduct. Because this review may require the collection and development of factual materials not now of record within the Department, it is not yet completed. I also asked the General Accounting Office for assistance, as may be appropriate.

The results of our review of employee conduct should not affect or relate to proposed procedures for future sales. Such procedures have been thoroughly examined by the Department's working groups, by the Under Secretary and by myself. I do not believe that it would be in the best interests of the Department or of the United States to require that resumption of the program should await completion of examination into individual conduct.

Our review of the Department's proposed procedures, as well as the report of the Commission, convinces me that we may soon be able to proceed with a responsible program for leasing Federal coal resources. However, I have directed that potential environmental consequences resulting from implementation of procedures proposed in the attached paper be thoroughly studied before final decisions are reached. The Department seeks only that use of Federal coal lands which reduces energy dependence while conserving total energy resources, and protecting the environment. As the Commission recognized, the continuation of a proper coal leasing program is in the national interest and essential to the national security.

The proposed procedures incorporate almost all recommendations made by the Commission. They provide a comprehensive framework within which responsible decisions can be made regarding future coal lease sales. These proposed procedures would restructure the Department's planning process to permit decisions to be made with fuller information and closer to the times of sales.

The proposed procedures provide long-range strategic planning guidance for the public concerning goals of the program based on best available estimates of future events. They provide for close consultation with State and local governments through the Federal-State Coal Advisory Board and Regional Coal Teams, throughout the process.

The procedures are designed to sharpen mechanisms for selecting tracts and for conducting lease sales. Building on the Commission's general recommendations, we propose specific procedures which will generate increased competition. Nonetheless, as the Commission recognizes, there will be a large number of tracts which receive but a single bid because of land ownership patterns. Accordingly, we have developed alternative procedures which, if enacted by the Congress, would allow the Department to negotiate the sale price of those tracts.

Finally, the proposed procedures incorporate Commission recommendations for validating the Department's appraisal methods. Prior to issuance of the Commission's report, the Department had contracted with the Colorado School of Mines to assess appraisal methods. Completed before the Commission made its report, the assessment concluded the Department's appraisal methods were similar to those used by industry and were appropriate. Also, the Oak Ridge National Laboratory is studying the Department's use of specific variables in appraisal processes. When this analysis is complete, the Department will finalize and publish a statement of its uniform appraisal method, as recommended by the Commission.

To assist in implementing the proposed program, the Department will establish, in the Bureau of Land Management, a centralized coordinating group for policy and analytic guidance, as proposed in the Department's Fiscal Year 1985 budget request. The formation of such a group was endorsed by the Commission. We also will implement plans to place greater reliance on regional teams with local representation, as proposed by the Commission.

The Commission's thorough report has stimulated public debate on coal leasing issues. I welcome this public interest in the Department's program, and I will make our report, as described in the enclosure, available to all interested parties for comment.

I look forward to working with the Congress in a mutual effort to address recommendations of the Commission and to ensure that the Federal coal leasing program serves the national interest.

Sincerely,

A handwritten signature in dark ink, appearing to read "William Clark", with a stylized flourish at the end.

William Clark



THE SECRETARY OF THE INTERIOR
WASHINGTON

March 19, 1984

Honorable Thomas P. O'Neill, Jr.
Speaker of the House of Representatives
Washington, D.C. 20515

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INTRODUCTION

This paper reports Department of the Interior plans for improved operation of the Federal Coal Leasing Program. These plans were developed as the result of a Departmental review of the program history and recommendations of the Commission on Fair Market Value Policy for Federal Coal Leasing. The Commission was established by Congress on July 30, 1983, in response to continuing questions regarding the coal leasing program. Its purpose was to review the Department's procedures to ensure receipt of fair market value for the leasing of Federal coal lands and to recommend improvements.

On February 17, 1984, the Commission transmitted its report to the Department of the Interior and to the Congress. The Department used the report as an integral part of its overall review of the program. The review built upon the general principles developed by the Commission. The Departmental report sets out proposed procedures which not only achieve objectives identified by the Commission, but also enhance the quality and credibility of the Department's decision-making process.

The Department strongly supports the Commission's conclusion that continuation of the coal leasing program is in the national interest. In addition to generating revenue, the program protects national security through reduced energy dependence, conserves total energy resources, provides coal at competitive prices, and protects the environment while treating residents of coal producing states fairly.

By December 31, 1984, the Department expects to have in place a decision-making process which will allow it to responsibly determine whether specific proposed sales will be in the national interest.

FEDERAL COAL LEASING LEVELS

The actual leasing of Federal coal lands is the last step in a long planning process designed to establish the amount of coal to be offered for lease and to identify the lands (tracts) that should be offered. The process involves two schedules. The first is a long range planning schedule for each region. This schedule covers four to five years and establishes the dates at which various steps in the leasing process take place. The second, a lease sale schedule, spans a much shorter amount of time; it represents the last step in the regional long range schedule.

The long range planning schedule is based on tentative long range projections of the Nation's possible need for coal. It projects timeframes for land use planning and coal activity planning, including tract delineation. Land use planning examines the compatibility of coal extraction with other land uses in a given area. Coal activity planning includes a review of the potential mining methods and environmental consequences. Tract delineation outlines potential leaseholds, the sum of which yield the maximum coal tonnage to be offered.

During coal activity planning, a preliminary regional coal leasing level is formulated by the Department, in consultation with the Governors of the affected States. The leasing level is the upper and lower limits or range of the amount of coal which might be offered for lease and is established as much as three years prior to the final sale date. The level is formulated primarily to initiate and guide the preparation of the environmental impact statement (EIS).

The EIS evaluates the impacts, both natural and social, that could result from the types and amount of activity indicated by activity planning and the coal leasing level. The proposed leasing alternatives in the EIS, except for the "no leasing" alternative, must fall within the leasing level range, which was established as part of activity planning.

Tract delineation occurs 18 to 24 months prior to the sale. The actual delineation follows completion of the EIS. This step completes the preliminary portion of the long range schedule. Following its completion, a decision point is reached which begins the lease sale schedule.

The date on which the lease sale schedule is initiated is specified in the long range planning schedule. In this schedule, after consultation with the affected States and the public, the Secretary determines which delineated tracts will be offered and the timing of the lease sale for a particular coal region. Historically, the sales have occurred about three months after the initiation of the lease sale schedule.

Since leasing was resumed in 1981, the long range planning assumptions have become the driving force dictating expectations and outcomes. Hence, assumptions made as much as three to four years before the sale have had a tendency to become solidified, and have limited flexibility in the decisionmaking process.

As a result of the Departmental review and the Commission's report and recommendations, the Department is proposing significant changes in its long range and short term planning process. These changes are designed to ensure that final decisions are made closer to the time of the actual sale. Decisions concerning coal leasing levels made as part of the long range plan will be treated as tentative, and will not have the solidifying effect experienced in the past. For future sales, more definite and specific plans will be formulated as part of the lease sale schedule decision.

The long range schedule will remain an important planning tool. It will ensure predictability by establishing parameters within which industry and other interested parties can plan. However, under these proposed procedures less emphasis will be placed on leasing levels at the early stages of the schedule. Levels developed in the early steps of the long range plan would be in the broadest range that permits planning and environmental analysis for National Environmental Policy Act compliance. Moreover, the actual timing of a sale will become dependent on the Secretary's decisions that initiate the final lease sale schedule. These decisions will be made when tracts are selected for offer.

This major shift in emphasis will add flexibility to the leasing process. Progressively greater specificity will be built into the overall sale schedule at the time of tract selection. Hence, the actual timing of the sale, the tonnage, and the tract selections will be based on the most recent analysis of economic and related data.

The Commission made six recommendations designed to ensure predictability in coal leasing while retaining the flexibility necessary to meet unexpected changes in the market or world situation, and to ensure broad participation in the decisionmaking process. The recommendations constitute objectives which the Department should consider as part of its coal leasing program. The Department supports these objectives and proposes to incorporate them into a refined leasing procedure which will help meet national goals.

Each of the Commission's recommendations are discussed below.

Recommendation III-I

The Commission recommended that the Government establish and announce in a timely fashion a coal leasing schedule to promote predictability and stability of Federal leasing actions. In doing so, however, the Commission believed the Government should have flexibility to change the timing of lease sales and the quantity of coal offered based on its assessment of emerging market conditions. The Department fully agrees with both objectives and proposes implementing them as part of its revisions to the coal leasing program. However, there obviously is some tension between them. The Department has sought to accommodate both goals by establishing different objectives in its long range and short term planning process.

The Department uses an established long range planning schedule to reduce uncertainty and to plan program and budget needs. Nonetheless, it realizes that unforeseen events may necessitate change in this schedule and that flexibility must be maintained. Accordingly, the Department's proposal will continue to maintain a long range (5-year) schedule for planning purposes, but will ensure that the need for a particular sale will be reviewed at multiple decision points during the process.

As part of its long range planning, the Department proposes providing a draft national schedule for review by the Federal-State Coal Advisory Board at its annual meeting. This schedule will estimate the dates of lease sale schedule decisions and will provide the number of projected sales which may result for the period. Hence, this Advisory Board will have a national focus.

As explained in more detail in response to later recommendations, in developing the long range planning schedule, advice will be requested from the Regional Coal Teams (RCTs) concerning regional planning schedules and environmental consequences. Further, recommendations on the proposed long range schedule will be sought from the Federal-State Coal Advisory Board. As part of this effort, the Bureau of Land Management (BLM) will regularly report projected coal market conditions to the Federal-State Coal Advisory Board.

Further, in developing the leasing level range during the activity planning phase of the long range schedule, consideration will be given to the items identified by the Commission's report. These items include:

- 1) Projections which provide indications of the need for coal to meet various programmatic objectives. These projections include: forecasts of regional coal production from the Department of Energy (DOE) and private forecasting services, utility estimates of future electric power consumption and plans for new power plants, and ongoing Interior Department and DOE monitoring of mine development plans in states containing Federal coal, including likely future capacity without further Federal coal leasing.
- 2) Determinations of needs by the Antitrust Division of the Justice Department, and the Departments of the Interior and Energy, to ensure enough diversity of reserve ownership to preserve competition among mining companies.

- 3) Limitations to leasing imposed by compliance with administrative requirements such as environmental analysis, land use planning, tract delineation, and receipt of surface owner consent.

The Secretary, in reviewing the coal leasing levels, will apply the appropriate national perspective to the individual regional leasing levels to assure that the aggregate coal being considered for offer is consistent with the national interest. The Bureau of Land Management would be directed to propose guidance for setting coal leasing levels by September 1, 1984.

These considerations would not only be analyzed in greater detail during coal activity planning but also would be examined at the time of tract selection. The Bureau of Land Management also would be directed to evaluate the proposed sale offering fully to determine how the most recent economic or other considerations affect the proposed sale. This evaluation will consider relevant market conditions including:

- 1) Current price trends of coal in that region.
- 2) New coal-fired power plants proposed for or under construction and their scheduled completion dates.
- 3) Current surveys of industry interest in the tracts.
- 4) Variations in transportation costs and capacities.
- 5) The availability of coal underlying Indian trust lands, which the Indian owners have decided to develop.
- 6) Any other factors affecting regional demands such as synfuel or slurry pipeline capability.

Under this proposal, the Bureau of Land Management will make this evaluation part of the Record of Decision which provides the rationale for the tracts selected and the sale date(s) chosen by the Secretary. It will constitute the first detailed

specification of potential tract offerings within the broad leasing levels projected earlier in the long range plan prior to preparation of the EIS. Additionally, at the time of tract selection, the Department will select a preferred leasing alternative. This alternative will be chosen from among the equally weighted alternatives identified in the earlier coal activity planning and EIS stages. This identification represents a departure from past practice under which the preferred alternative was identified earlier in the process and, as a result, had a tendency to drive later decisions and expectations.

Further, to assure the Secretary's decision remains appropriate, the factors outlined above would be evaluated immediately prior to the publication of the sale notice which occurs about 30 days before the sale date. If this evaluation demonstrates that the offering is no longer appropriate, the Department will change the offering. Thus, under these proposed procedures, detailed planning will occur closer to the time of sale assuring the Department retains needed flexibility. Long range planning will focus on providing the public with the best available information about the direction of the program.

The Commission also suggested the use of smaller phased sales rather than a single large regional sale to provide market signals to the Department to guide it in making more appropriate lease sale decisions. The Department believes this suggestion may have merit and will consider the design of a test of this method as part of a future lease offering.

Recommendation III-2

The Commission recommended that to maintain a responsive and orderly coal leasing process, the States, through their participation in the Regional Coal Teams and the Federal-State Coal Advisory Board, should continue to play a significant role both in establishing leasing levels and setting leasing schedules. The inclusion of State personnel in providing staff support to the Regional Coal Teams is encouraged.

The Department has and will continue to support State representation. The contribution of the RCTs and the Federal-State Coal Advisory Board is extremely important. The Department will continue to work with and through these groups to develop appropriate leasing schedules and appraisal methodologies. As has been noted, the Department will seek the recommendations of the Federal-State Coal Advisory Board on the long range planning schedule. The RCTs also will retain a significant advisory role in the establishment of regional coal leasing levels and tract selection. Moreover, to the maximum extent possible, the RCTs should solicit the views of the public at each key decision point, and should consider the use of newsletters and other memos for communicating with the public.

The Department will encourage State staff support for the RCTs on a sale-by-sale basis. The technical analyses and professional opinions of State personnel will be considered, along with those of BLM personnel, in the final deliberations of the RCTs. Additionally, the RCTs will continue to be utilized by the Department as the major tool for Federal-State conflict resolution so that both Federal and State concerns are given the proper consideration. Further, a Washington representative will be assigned to work with each team as an ex officio member.

Recommendation III-3

The Commission advocated that the Government should neither seek to raise the coal lease price above the competitive market level by limiting the amount of coal Federal leasing policies make available to the market, nor lease so much coal as to flood a depressed market. The Department concurs with this recommendation.

The Department will endeavor not to restrict coal supplies in any region in such a way that prices are increased above the competitively determined level. Further, the Department will attempt not to set leasing levels in any region so that it unduly adds to reserves. The Department recognizes that the task of considering market conditions is one which involves great uncertainty because of the dynamic and

time-consuming nature of the leasing process. For this reason, the Department previously directed RCTs to consider the following in developing the ranges which constitute leasing levels:

- 1) Coal production capacity projection
- 2) Coal reserve inventory
- 3) Competition for new coal supply contracts¹
- 4) Industry expressions of interest
- 5) The need to maintain existing operations ("minimum leasing")
- 6) Past lease sales

Each of the above focuses on different objectives that need to be considered in establishing leasing levels. By considering all the objectives and by evaluating them against public policy needs, the Department believes it can establish leasing levels that promote rational leasing decisions which will conform to the objectives suggested by the Commission. No one of these by itself is an adequate indicator of what Federal leasing levels should be, given the disparate objectives of the program.

¹A depressed coal market is one with unusually high levels of excess capacity of reserves. The third item above is particularly important in identifying existing excess reserve capacity. If there is not adequate competition for new coal supply contracts, fair market value will suffer. As the Commission pointed out, "As previously leased coal moves into production, new leasing is triggered to maintain a target inventory of leased but undeveloped coal available for new coal mining competition." The target inventory of reserves requires an evaluation of the existing and anticipated excess reserve capacity. An appropriate target should lead to adequate amounts of competition and should not exacerbate depressed market conditions.

Recommendation III-4

The Commission recommended the Government seek to provide adequate diversity in quantity and quality of Federal coal lease holdings offered for sale to encourage active competition among mining companies because of the benefits to consumers such competition may produce. The Department concurs with this recommendation.

To promote diversity, the Department currently offers tracts in many production regions. These coal regions vary in the types and quality of coal they contain. One of the objectives of the planning process used by BLM is to develop a cross-section of maintenance and new production tracts. This cross-section assures tracts offered will differ in size, coal type, geographic location and mining configuration. The tract delineation recommendations, advocated by the Commission and supported by the Department, also will help achieve this goal.

In addition, RCTs consider the diversity of tracts within regions when selecting tracts for regional analysis. Further, expressions of leasing interest from industry which, in part, respond to the diversity of demands from coal consumers in many different markets, help ensure offered tracts are diverse. Finally, the Department currently chooses tracts so that the tracts will be of interest to different companies. This selection helps promote competition for contracts to deliver coal to consumers (see Recommendation III-3).

Recommendation III-5

The Commission stated the quantity of coal leased should be determined to ensure the Government receives a fair return consistent with the achievement of other public policy objectives, such as promoting efficient land use and environmental planning and conserving appropriate amounts of coal for the future.

The Department agrees with this statement. The Department's policies and procedures for land use planning currently consider lands containing coal deposits are best suited for coal leasing or for other competing uses. The Regional Coal Teams, in making their recommendations, and the Secretary, in establishing the coal leasing levels, consider multiple use objectives as part of the leasing level process. Accordingly, the Department's regulations (43 CFR 3420.2(B)) state "The Secretary shall establish leasing levels by region for the purposes of approximating the amount of coal to be offered through proposed lease sales schedules after consideration of potential policy conflicts...." Moreover, as indicated in the discussion under Recommendation III-3, the Department is prepared to consider a variety of measures aimed at different program objectives in setting leasing levels.

Additionally, during activity planning, coal tracts are ranked and selected by Regional Coal Teams based on such factors as coal resources and economics, impacts on the natural environment, and socioeconomic impacts. Ranking assists in planning socioeconomic mitigation measures. Potential tracts also are fully analyzed during the preparation of the EIS. Finally, the suitability of a tract for coal production is again considered at the time of tract selection.

The Department recognizes that the Commission deliberately chose to use the term "fair return" in this recommendation rather than "fair market value." This term clearly implies that the goals of the program go beyond maximizing revenues and encompass other national concerns. The Department recognizes the need for sensitivity to these broad concerns.

A study of environmental protection in the leasing program is now being made by the Office of Technology Assessment (OTA). The Department will carefully review the findings of the final report of the OTA. Within 45 days of receipt of the OTA Report, the Department will report to Congress on the Department's assessment of OTA's findings and their relationship to the Commission's recommendations and its own review.

Recommendation III-6

The Commission stated that the appraisal of the adequacy of coal leasing is critically dependent upon the extent to which pending preference right lease applications (PRLAs) are granted and that the Interior Department has proceeded very slowly in this area. The Commission recommended the review of these applications be rapidly completed, preferably within the next two years. Further, it recommended stress be placed on those areas in which a lease sale is scheduled approximately in the next year, and that in deciding on the appropriate level of future coal leasing, the amount of coal that might be provided through preference right leasing should be taken into account.

The Department agrees with this recommendation and proposes taking steps to implement it. Pending preference right lease applications were filed under a noncompetitive coal leasing provision of the Mineral Lands Leasing Act of 1920. This provision was repealed by the Federal Coal Leasing Amendments Act of 1976 (FCLAA). However, it included a grandfather clause protecting the valid and existing rights of applications on hand. If the application meets the statutory requirements, a lease must be issued by the Department.

The processing of preference right lease applications may place new Federal coal into the market place. Currently, 137 PRLAs remain in various stages of processing (Alaska, 2; Colorado, 17; Montana, 4; New Mexico, 26; Utah, 12; Wyoming, 76). These cover 316,483 acres and contain an estimated six to seven billion tons of recoverable coal. Forty-seven PRLAs have been processed to completion since 1977. From these, 13 leases were issued covering 23 PRLAs and 24 PRLAs were rejected or withdrawn. Because of the FCLAA repeal, there can be no additional PRLAs filed.

Since 1979, the Department has been committed to completing the processing of these preference right lease applications and has made some progress toward this goal. Progress, however, has not been as rapid as desired. Delays have resulted from implementation

of improved guidelines for preference right lease application processing and the need to achieve full and complete compliance with the National Environmental Policy Act.

The Department recognizes the interrelationship between preference right lease applications and the competitive leasing program. The Bureau of Land Management has drafted a revised processing schedule (see Table 1) for all remaining coal preference right lease applications. This schedule provides for the completion of most of the preference right lease applications within the next two years.²

The Department is prepared to consider the amount of coal that may be leased and potentially mined through preference right lease applications when establishing leasing levels and future regional coal planning schedules. Estimates will be based on the probability that a certain amount of coal from preference right lease applications will be leased and mined. Factors also to be accounted for in this context include the consideration of the proximity to existing mines or leases; fee, Indian, and State coal ownership; transportation; and the reasonable expectation the coal is minable under existing laws and regulations.

²Further processing of some preference right lease applications in New Mexico, Utah, and Montana in Wilderness Study Areas is prohibited in FY 1984 by the FY 1984 Interior Appropriations Act. The Department's ability to process these preference right lease applications to completion is contingent upon removal of this prohibition.

Table 1
PRLA Processing Completion Dates

	FY 84				FY 85				FY 86				FY 87				Remarks
State	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4	
Alaska (2)									2								
Colorado (17)					2	2	3	8	1				1				
Montana (4)																	
New Mex. (26)					26												
Utah (12)																	Court reinstated 6 additional prospecting permits, which, if meeting initial showing, will be included with these; same FIS as Uinta III.
Wyoming (76)					6	6			14	7	43						IBLA 83-571 upheld Peabody appeal on 6 PRLA's prev. rel. by WSO
Total (137)	1				34	8	3	8	15	7	45	3	1			12	

SELECTING TRACTS FOR COAL LEASING

The tract selection process is critical to the success of the Federal Coal Management Program. The selection of appropriate tracts is important not only to ensure appropriate competition and coal production, but also to ensure the protection of the environment. Insufficient competition for coal leases is a continual and serious problem in the tract selection process. However, as the Commission recognized it is not realistic to expect competition for all tracts, and the tract selection process must reflect a variety of policy goals.

The Department is already taking steps to modify the tract selection process to stimulate further competition for individual tracts. The Commission proposed four tract selection recommendations which the Department will implement as part of its proposed procedures.

Recommendation IV-1

The Commission recommended tracts be selected in such a manner that their characteristics will enhance the attainment of fair market value.

A primary objective of the Federal Coal Management Program is to promote efficient patterns of coal development while providing ample environmental protection and stimulating competition. The processes of tract delineation and tract selection must consider all available information including resource data from regional studies, industry expression of interest, transportation, and ownership patterns.

The Bureau of Land Management has been directed to study and list the factors assessing the degree of competition in the process of tract delineation and tract selection. These factors will be developed by June 15, 1984, and offered for public comment. In addition to considerations contained in Recommendation III-4 of the Commission's report, these factors will include tract size, ownership configurations, and the expectation that the tract will not create a future bypass or captive situation.

In addition, by June 15, 1984 the BLM will develop and offer for public comment proposed procedures for assessing alternative tract configurations. Alternative configurations may enhance potential competition and may allow the Department to experiment with smaller tract sizes. One procedure that will be considered by the BLM is offering alternative tract configurations using the same parcels of land. This procedure allows the Department to choose those bids that represent the combination of tract configurations and bonuses that best promote leasing goals. Under this procedure for example, if a particular parcel of land could be divided logically into three different tract configurations, the Department would solicit bids on each tract, each pair of tracts, and on all the tracts combined. The Department would then evaluate the bids and select the tract configuration that best meets the program's objectives.

Recommendation IV-2

The Commission recommended that the Interior Department sponsor more drilling for use in tract delineation and encourage cooperative drilling in which any additional firms could participate by paying a pro-rated charge, even after the exploratory drilling has been concluded.

The Department concurs with the recommendation and proposes that it sponsor more Federal Government drilling as well as encourage private-sector drilling. However, the Department is concerned about the potential effect that forcing private firms to share exploratory drilling results, even with compensation, may have on the willingness of firms to undertake exploratory drilling. The Department is anxious to obtain public comments on this issue.

Obtaining drilling information for a regional understanding of the extent and quality of the coal resource will aid in bringing more new production to the market and foster competition. This wide-spaced drilling and additional, tract-specific drilling would assist the tract selection, tract delineation, and tract appraisal process. Tracts will not be delineated or selected unless the Government has

adequate knowledge to evaluate potential trade-offs. Also, tracts will not be offered for lease unless the Government has adequate coal data to appraise their value. Further, the Bureau of Land Management is about to issue instructions to ensure that tracts are evaluated on a continuing basis throughout the prelease process to determine coal data adequacy.

The Commission also recommended the Department consider changing its regulations to require that licensees allow any firm to purchase information on a pro-rata basis after the licensee has completed exploratory drilling. Exploration licenses are issued currently by the BLM to private individuals who are interested in drilling for Federal coal. The BLM encourages this drilling to be done on a cooperative basis in order to minimize costs and environmental impacts as well as to share valuable information regarding coal quality and quantity. Licensees currently are free to sell information to others.

The proposed change would require this sale to other interested parties after the drilling takes place. The change may increase the number of bidders because it would make it easier for them to obtain information. It also may decrease environmental impacts by limiting exploratory drilling to one company or group of companies.

Nonetheless, the Department is concerned the change would reduce the incentive for companies to conduct exploratory drilling, thus reducing the amount of coal data submitted by industry to the Government. It would benefit those companies that let others take the risk of exploratory drilling while penalizing those that are willing to take this risk. Therefore, the Department requests public comment, including comments on the advisability of accepting this recommendation on an experimental basis to assess its actual effect.

Recommendation IV-3

The Commission advocated cooperative leasing procedures to obtain logical mining units that may be reasonably expected to receive greater bidding competition.

The Department favors cooperative leasing procedures and has previously initiated attempts to encourage them. In situations where the Federal Government manages fragmented or checkerboard coal ownership, it may be feasible to combine the Federal, private, and State coal so that they can be offered for lease at the same time. Consolidation would stimulate competition and form viable economic mining units. Accordingly, the Bureau of Land Management is being directed to identify and to pursue opportunities aggressively for cooperative leasing. When identified, these opportunities will be presented to the Regional Coal Teams.

Recommendation IV-4

The Commission recommended that the exchange of Federal and non-Federal coal tracts be pursued more vigorously, but in a careful and prudent manner, to consolidate Federal and non-Federal coal lease holdings of equivalent value into logical mining units. The Department has been pursuing this objective. Consolidating Federal coal ownership enhances the Department's ability to apply sound multiple use management and provides greater opportunities for the development of economic coal resources. The Bureau of Land Management has been directed to continue to pursue and evaluate potential fee exchanges under section 206 of the Federal Land Policy and Management Act of 1976 (FLPMA). In order to implement this authority, the BLM adopted an exchange policy on September 26, 1983 for privately-owned leasable and salable minerals (see Attachment I, Bureau of Land Management Instruction Memorandum 84-81, dated November 1, 1983). The BLM has been directed to amend the above cited memorandum, by June 15, 1984, by adding an explicit condition dealing with environmental concerns to its list of when an exchange is in the public interest.

Further, the Department recognizes that in fee exchanges involving Federal coal, a major concern is the potential impact on competition. Hence, in processing fee coal exchanges, the Bureau of Land Management routinely will request a Department of Justice review comparable to those conducted under section 15 of the Federal Coal Leasing Amendments Act.

COAL LEASE SALES PROCEDURES

The procedures used for selling coal leases have a substantial effect on whether the Government is able to receive "fair market value" for the tracts offered. These procedures structure the competitive bidding process and offer opportunities to compensate for inadequacies in competition. They must both be objectively sound and maintain public confidence in the sale. The Department recognizes the need to maintain public confidence is particularly great in a program such as coal leasing where frequently only a single bid is received for an individual tract.

The legislative foundation established for the coal leasing program was built in large measure upon the assumption there would be competition for coal tracts. As a consequence, Congress required that all coal leases be awarded through competitive sales. This assumption, however, has proven incorrect. Since 1975, only 31 of 91 tracts have received more than one bid. Although the Commission's recommendations for tract selection will increase competition (see Recommendations IV-1, 2, 3, and 4), there still will be a substantial number of tracts that receive only a single bid. The sale procedures used by the Department must reflect this fact.

The Commission advocated recommendations it believed will promote competition or will help ensure the Government receives fair market value for those tracts which receive only a single bid. The Department agrees with these recommendations and proposes to take the steps within its authority to implement them as part of its efforts to improve its sales procedures.

Recommendation V-1

The Commission stated the Government should have leasing policies that distinguish between new production tracts and maintenance and bypass (m & b) tracts. The Department agrees with this recommendation. Its implementation is discussed below and in the discussion of the other more specific Commission recommendations contained in this chapter, especially Recommendation V-6.

The current coal leasing program addresses this problem, in part, by informally classifying tracts as new production or as maintenance and bypass tracts. M & b tracts generally only continue operations at the existing scale, so tract tonnage is not counted against regional coal leasing levels. However, the sales procedures do not recognize this distinction. Further, tract classification does not necessarily focus on probable competitive status, i.e., single or multiple bid.

To better distinguish between new production and m & b tracts, the Department proposes to formalize definitions for these tracts. It will ensure that its definitions of new production and m & b tracts distinguish captive, single bidder tracts from potentially competitive tracts. The definition of new production tracts will identify tracts not associated with any existing production but which are still captive to a coal company with a strong position in adjacent coal, surface, and/or access rights. Similarly, m & b tracts that might be competitive because of their location between two possible mining operations will be identified separately.

These proposed changes are scheduled to be adopted by August 31, 1984. Following adoption, all tracts delineated for consideration to offer shall be classified and fully described in the terms set out above in all coal leasing decision material prepared for consideration by the Regional Coal Teams and the Department.

Recommendation V-2

The Commission recommended that in the conduct of lease sales the Government should continue to rely on bonus bidding. The Department concurs with this recommendation and will continue to employ bonus bids with fixed royalties.

The Department has experimented extensively with alternative bidding systems including royalty bidding, work commitment bidding and profit share bidding. These experiments demonstrated that cash bonus bidding

with a fixed royalty rate is the most suitable system for awarding leases. At a "reasonable" fixed royalty rate, the risk of development is shared with the lessee, the amount of up-front money required under a fully cash bonus system is reduced, and downstream production effects are minimized. Consequently, a "reasonable" fixed royalty rate coupled with cash bonus bidding results in the Government leasing the resource to the most efficient developer while taking into account equity considerations.

Recommendation V-3

The Commission recommended intertract bidding be used in appropriate cases. The Department agrees, in appropriate cases, intertract bidding is desirable. For example, the tracts should be in the same general area and should have similar characteristics. It may serve to create competition among single bidder tracts because the bidder is no longer bidding against only those bidders interested in a single tract, but all bidders taking part in the intertract sale.

The Department was prepared to use intertract bidding in 1982 but was prevented from doing so because of surface owner consent considerations. Because of the Department's interest in using this type of bidding in previous sales, it had previously developed procedures to govern intertract bidding. These procedures will be amended so only the bids on tracts awarded will be made public.

The Department has not, however, adopted guidelines to define circumstances in which intertract bidding is appropriate. Such guidelines are critical to the institution of a consistently successful intertract bidding program. The Department has directed BLM to develop and publish draft guidelines by June 15, 1984. These guidelines will provide that intertract bidding will be considered only after the Department receives the advice of the Regional Coal Teams and the affected State Governors.

Recommendation V-4

To promote more competitive bidding, the Commission recommended the Government test the feasibility of and experiment with a variety of auction techniques.

Although the Department has had extensive experience in alternative bidding systems as discussed in Recommendation V-2, Congress mandated sealed bids for Outer Continental Shelf leasing. Accordingly, there has been no experimentation with alternative auction techniques. Some techniques, such as the "Dutch" auction and "second chance" systems, show promise as alternatives to sealed bids. Unfortunately, much of the literature and experience on the various auction techniques is based on a greater number of bidders than is traditional in coal sales. However, the Department will request public comment and consider experimentation with a variety of techniques.

Recommendation V-5

The Commission recommended minimum submissible bids be established on a regional basis and that this minimum be expressed as an amount per ton. The Department tentatively concurs with this recommendation, but will solicit and analyze public comment before it promulgates a final rule.

This recommendation encompasses three issues of critical significance to the program. These are: 1) whether the Department should use a minimum submissible bid or an entry fee; 2) what the basis for the minimum bid should be; and 3) whether the bid or fee should be set on a regional or national basis.

The Department believes it should continue to use a minimum submissible bid rather than entry fees. A minimum bid does not establish the lowest acceptable bonus bid. Rather, it provides a starting point for each sale. The use of a minimum bid not only protects against frivolous or nuisance bids, but also provides an opportunity for bidding information to be developed

which can be used in the post-sale appraisal. It gives the Department a basis on which to evaluate bids when the appraisal is negative. For captive tracts, minimum bids also eliminate premature leasing of tracts that have present worths below that minimum, thereby reducing the risk of overleasing. Finally, a minimum bid stakes out a nonnegotiable share of the economic rent of coal development which cannot be absorbed by surface owners or coal transporters.

A fixed nonrefundable entry fee also may protect against frivolous bids. It also reimburses the Government for the cost of the sale, possibly including exploratory drilling (See Recommendation IV-2). Further, because it is unrelated to the value of the resource, it is easier to calculate and to administer.

Fees, however, because they are nonrefundable, may inhibit competition by deterring firms from entering the bidding process. This possibility is particularly applicable if the costs of Governmental exploratory drilling are to be defrayed through the fee. Further, a fee is of no assistance in evaluating bids for captive tracts. Because of the need to spur competition and because the use of a minimum acceptable bid achieves the same advantages as an entry fee, the Department believes a minimum submissible bid is preferable.

The Department also believes the minimum bid should be established on a cents per ton basis. This basis more accurately represents the economic value of the tract because all tracts do not have the same amount of coal per acre. In fact, the quantity and quality of coal per acre can vary quite dramatically. Because of this variance, coal bids made on a cents per ton basis will permit the Government to identify coal tracts in the order of their economic rents. That is, the tract with the highest economic rent will have the highest cents per ton bid, the tract with the second highest economic rent will have the second highest cents per ton bid, and so on. As a result, the Government can determine and promote the optimal order of coal development on Federal lands. Using a per acre minimum may distort the economic value and may result in a situation where tracts with a lower

economic value receive bids while tracts with higher economic value do not.³

The Department recognizes that the use of a cents per ton measure to establish a minimum bid in the coal program is inconsistent with the bidding mechanisms for other Federal leasable mineral programs. Therefore, the Bureau of Land Management has been instructed to evaluate the actual impact of the use of this measure after the next coal lease sale and to consider whether it should continue to be used.

The Department considered a third possibility -- setting the minimum submissible bid at the Government's presale appraisal price. This option was rejected because it places too much weight on the presale appraisal. Because of the difficulties inherent in placing a fair value on a Federal coal lease, which are discussed at length in the Commission's Report, it is an uncertain measure at best. Using it to establish a minimum bid reduces the role of the market and may inhibit competition. It may also make it more difficult to determine "fair market value" because it impedes the post sale analysis (see Recommendation V-7).

³The following example illustrates this possibility:

<u>Tract</u>	<u>Economic Rent Per Ton (¢/ton)</u>	<u>Quantity of Coal (ton/acre)</u>	<u>Maximum Industry Bid (\$/acre)</u>
A	10	700	70
B	4	3,000	120

The maximum amount industry will bid per acre is the product of the economic rent per ton and the number of tons per acre. Tract A has the highest economic rent but, because there is less tonnage per acre, the per acre bid falls below the current \$100/acre minimum submissible bid. Tract B has less economic value per ton, but because of the large tonnage per acre, the per acre bid is higher than the minimum acceptable bid. Assuming that the reservation value for B is below the amount bid, Tract B will be leased while Tract A will not even receive a bid. The higher quality coal, consequently, will remain unleased while the higher quantity coal will be leased.

The Department also agrees with the Commission that minimum bids should be set on a regional basis. Although there are variations within each region, these differences are not as great as between regions. Moreover, a national minimum may well be meaningless in high value regions because it would have to be very low so as not to preclude leasing in low value regions.

Recommendation V-6

The Commission believed that wherever possible, leases should be sold on a competitive basis. However, the Commission recommended that where reasonable efforts to obtain competitive bids have failed, the Government should have authority to negotiate a fair price.

The Department agrees with this recommendation in principle. Some form of negotiating authority clearly is desirable given the frequency of single bid tracts (see Recommendation V-1). Negotiating bids for captive tracts would allow the Department to behave in a more business-like manner in the leasing of tracts and to increase the return from captive coal tracts, which have historically been leased for regulatory minimum bids.

Nonetheless, the Department recognizes in any situation in which the Government is negotiating a contractual arrangement, there is an increased possibility public trust could be abused. As a result, there is a heightened need to develop procedures which will promote public confidence. Moreover, the Department believes that although it might be possible to craft a negotiating procedure within existing legal authorities, a change of this magnitude should not be undertaken without express Congressional approval. Accordingly, the Department requests public comment on the possible conceptual approaches, which will be published by June 15, 1984, including those described below, and will work with Congress to determine whether a feasible approach can be defined.

APPROACH 1

First, the Government would identify the tract which is expected to be of interest to only one bidder, i.e., a captive tract (see Recommendation V-1). The Government then would announce its intent to negotiate with a particular company for that tract unless it received indications from other companies of their intention to submit bids. If no intentions to bid are received, the Government and the named coal company would negotiate a final price for the coal tract. This price would be published and higher bids would be solicited. If any company indicated an intention to bid, these companies, along with the original company, would be given an opportunity to submit a best and final offer. The tract would be sold to whomever is the highest bidder.

APPROACH 2

The tract would be offered in a competitive sale with a concealed reservation value approximating full value to the adjoining lease holder. If the tract receives only one bid and if that bid is under the reservation value, the Government and the bidder would negotiate a price through a post-sale process operated similarly to that used by the Government for letting contracts. The lease would be let if a reconstituted sales panel approves the negotiated results (see Recommendation VIII-4).

APPROACH 3

The tract would be offered in a competitive sale with a concealed value approximating full value to the adjoining lease holder. After initial bids were submitted the sale panel would announce a preliminary decision to accept or reject the bid. The sale is kept open and the pre-established value remains concealed. The bidder then would be allowed one opportunity to adjust his bid. After this opportunity, the sale is closed.

Recommendation V-7

The Commission believed the industry bids on tracts in a lease sale on which there was extensive competition, along with the Government's pre-sale appraisals, can constitute appropriate and important

sources of information for post-bid acceptance and rejection decisions. This was the basis of the post bid acceptance and rejection process used by the Department in the 1983 Fort Union Coal Lease Sale (see Attachment II, Bureau of Land Management Instruction Memorandum 83-734, dated July 26, 1983). The Department will continue to use industry bids in its acceptance and rejection decisions for all tracts. This information will be used both for tracts in which there is more than one bid and for establishing comparison values in single-bid tracts.

The Department will evaluate its current requirement, that bids used in the post-sale appraisal process must be at least 25 percent of the pre-sale appraisal. The percentage in this requirement should be set low enough so it does not interfere with legitimate competition and market operation. It should, however, be set high enough to screen out nuisance bids and to deter collusive bidding. The Department has directed the Office of Policy Analysis, under the Assistant Secretary--Policy, Budget, and Administration, to conduct this evaluation by July 31, 1984.

Further, the Commission suggested that the Department keep knowledge of amounts bid on single-bid tracts from the evaluation team until they had completed their reappraisals of such tracts based on multiple-bid tract results. It believed this practice would avoid any potential bias in the evaluation of these tracts. The Department will adopt this suggestion.

The Department also believes it must move quickly to document its pre- and post-sale appraisal procedures and distribute them for comment. Accordingly, the Bureau of Land Management has been directed to document and make available its proposed sale appraisal procedure for public comment by September 1, 1984, incorporating the points made above.

Recommendation V-8

The Commission recommended that the Government take the necessary steps to ensure the security of confidential data prior to lease sales.

The Department concurs with this recommendation and has implemented it. As noted in the Commission report, the Bureau of Land Management already has issued detailed guidance to its field offices with regard to security of confidential data (see Attachment III, Bureau of Land Management Instruction Memorandum 83-794, dated August 24, 1983). This directive will be updated and incorporated into appropriate manuals by July 31, 1984. Responsible officials will ensure procedures are reviewed prior to each lease sale to ensure appropriate sensitivity. Further, the BLM will provide the necessary training in advance of each sale to ensure its employees are aware of these requirements and have the knowledge necessary to implement them.

APPRAISAL METHODS

Appraisals of the value of tracts to be leased is critical in ensuring that the Department receives fair market value in Federal coal lease sales. The Commission spent a considerable amount of time assessing the methods and procedures used by the Department in appraising tracts. It concluded that the appraisal process is, at best, an inexact science and that it is not uncommon for different appraisers to arrive at widely different results. The Commission determined that the Department's basic appraisal methods are widely accepted within the appraisal profession and industry. This determination corroborated the findings of the Colorado School of Mines who had previously reviewed the appraisal procedures and models for the Department.

The Commission concluded that although the application of these methods presents unusual difficulties in the context of Federal coal leasing, it could not identify any superior methods. Nonetheless, the Commission developed a series of recommendations concerning the factors that should be considered and the information that should be obtained by the Government as part of the appraisal process. Moreover, because of the imperfections inherent in the appraisal process, the Commission concluded that it is imperative the Department develop methods and procedures that are unassailable not only in fact but also in public perception.

The Department agrees with six of the seven recommendations made by the Commission. The only exception is a recommendation that would require industry representatives who bid on Federal leases to disclose the terms of comparable private transactions in which they have engaged.

Recommendation VI-1

The Commission stated that the Department of the Interior's basic methodologies for estimating fair market value are widely accepted by appraisers by in industry and government. However, the Commission recommended that model design, input data, and analysis be improved.

As stated previously, the Department has been cognizant of the importance of both the basic methods used by the Department in appraising coal lease values and the specific application of those methods to any coal lease tract. An independent review and analysis of the Department's appraisal methods by the Colorado School of Mines in August 1983 indicated that these methods are widely accepted by industry. In addition to this analysis, the Bureau of Land Management had concurrently contracted with the Oak Ridge National Laboratory to analyze the applicability of specific physical variable inputs to the current BLM appraisal models.

Additionally, the Department will accept the Commission's suggestion that it evaluate the use of "Monte Carlo" techniques and compare its Coal Resource Economic Value (CREV) model against other similar models. The evaluation of model designs and input data will be completed by December 30, 1984. Further, the Department will make its coal evaluation methodologies available and will explain how they are applied in the analysis of coal lease tracts.

Recommendation VI-2

The Commission concluded that a "small business" tax adjustment should not be made in computing appraisal value. The Bureau of Land Management has eliminated this adjustment. It was not used in the appraisals of the tracts in the 1983 Fort Union Coal Lease Sale or in the 1984 Paonia 'D' coal seam lease tract.

Recommendation VI-3

The Commission concluded the comparable sales adjustment procedure should include factors, such as production rate, stripping ratio, and coal quality, that are identified as appropriate through a comprehensive review of appraisal techniques.

The Department agrees with this recommendation and had begun conducting such reviews prior to the Commission Report. As noted in response to Recommendation VI-1, the Department had contracted with the Oak Ridge National Laboratory to develop and analyze potential variables for the appraisal procedure. In a summary of the final report "The Relationship Between Stripping Ratio and Production Rate in Surface Mines of the Powder River Basin and Green River-Hams Fork Region", the Oak Ridge National Laboratory concluded the Department was correct in its treatment of stripping ratio and production rate as separate and independent variables in its appraisal methods (see Attachment IV).

Of particular concern is the need to consider variables measuring economies of scale and production rate. Also of concern is the need for improvements in royalty and severance tax adjustment procedures used in comparative sales analysis. The Department will continue to seek professional comment and guidance on Federal appraisal techniques.

Recommendation VI-4

The Commission recommended where a Federal tract is of use to only one party and no competition is expected, estimates of tract value should be based on the value of the tract to the adjoining mine or coal owner, rather than on the "competitive" or "stand alone" value.

The Commission explained several of the problems inherent in evaluating captive tracts. The Department concurs with the discussion of the issues and the recommendation that captive tracts be assessed on the value to the adjacent mine or lease holder. However, the Department is unsure of how this value should be assessed. Accordingly, the Department seeks public comment on this issue and will highlight it in the Department's draft uniform appraisal methods to be made public by September 1, 1984.

The value of a captive tract, if assessed as an independent unit is typically negative, i.e., the costs of mining the coal independently of an existing mine are greater than the expected return. If the value were positive, it would be profitable for a company to mine it as an independent tract and it would no longer be considered captive. The captive tract, however, clearly has some value to the adjoining owner. Hence, the value of the tract should be assessed as if the tract were a part of another mining unit.

The exact value, however, is difficult to determine. First, it is difficult to establish the degree to which fixed costs in the adjacent lease should be used to offset the amount paid for the captive lease. Thus, a discounted cash flow model is difficult to apply. Judgments must be made about which parts of the model would require adjustments (e.g., tax algorithms) and which costs should be allocated to the new portion of the mine. Second, there is no determined allocation of the inherent value of the coal in the captive tract between the bidder and the Government.

Thus, the comparable sales appraisal methods do not seem as good a basis for evaluation unless the comparable sale mimics the same "captive" conditions, such as the relative importance of the captive area to the adjoining area and the ownership patterns (e.g., railroad checkerboard pattern).

Recommendation VI-5

The Commission recommended the Department require lessees to report details of Federal lease assignments. Departmental regulations currently require the reporting of details of Federal lease assignments. However, the lack of specificity has resulted in inconsistent information being reported. The Bureau of Land Management will submit for public review by June 15, 1984 specific guidance for its field offices on the information required. Moreover, to ensure that the Government receives complete information on lease assignments, the BLM has been directed not to approve assignments unless appropriate information is provided by the assignee.

Recommendation VI-6

The Commission recommended that industry representatives wishing to bid on Federal leases provide to appropriate Federal Government representatives information regarding prices and other terms of private coal transactions that may be needed for comparability analyses. Further, the Commission stated the confidentiality of such information should be fully protected.

Although the Department agrees that comparable sales information is an important factor in appraising the value of Federal tracts, it believes that implementation of this recommendation would be counter-productive. First, this requirement might inhibit competition. Some companies would rather not bid than disclose this information. Second, the value of such information is limited because of the differences the Commission identified between Federal and private market transactions, i.e., due diligence standards, environmental constraints, and surface owner consent requirements. Third, the policing of the accuracy of this information would be difficult. Accordingly, the Department does not believe it should change its current policy, which seeks voluntary contributions of information regarding private transactions.

Recommendation VI - 7

The Commission recommended the Department of the Interior enhance its capacity to perform appraisals. It stated this enhancement should preferably be done by expanding in-house resources. However, it concluded the Department should rely on outside appraisers, where necessary, or some combination of these approaches.

The Department recognizes appraisals must be of high caliber and integrity and is committed to continue enhancing its capacity to perform appraisals. The Bureau of Land Management has been directed by June 30, 1984 to develop a plan, including cooperation with the U.S. Geological Survey and other agencies, to increase the number of highly competent

mineral appraisal personnel, improve the professional capabilities of currently employed personnel, and consider the use of private sector appraisal expertise. Further, the Office of Personnel Management will be requested to examine pay comparability between the public and private sectors for these professionals, and the possibility of treating mining engineers, geologists and minerals appraisal specialists as shortage occupation categories.

KEY STATUTORY AND RELATED FACTORS

The Commission's primary task was to examine the administration of existing laws. However, the Commission concluded that no matter how well the statutory requirements were administered, certain of the laws themselves would still impede the Government's ability to achieve fair market value. Accordingly, it made a number of recommendations for Congressional action. The Department of the Interior has reviewed these recommendations carefully and would be pleased to work with Congress in addressing the areas of concern identified by the Commission.

Recommendation VII-1

The Commission recommended that for post-1976 leases the 10-year diligent development requirement should continue in place, but also recommended that Congress consider allowing a 10-year extension be provided on the payment of advance royalties on an escalating basis. This escalation basis should be set at a level designed to stimulate timely development.

Section 6 of the Federal Coal Leasing Amendments Act of 1976 (FCLAA) requires production of coal in "commercial quantities" within 10 years of lease issuance and specifies that any lease not producing coal in "commercial quantities" at the end of the 10 year period shall be terminated. Under Department regulations, a lessee must produce one percent of recoverable coal reserves by the 10th anniversary of the lease to meet the "commercial quantities" requirement.

The Commission found that diligent development requirements play a central role in the coal leasing program because they provide a substantial degree of Federal control over the efficient development of coal resources and because they ensure that long term increases in value are retained by the Government. Nonetheless, the Commission determined that the 10 year "produce-or-lose" requirement creates significant problems. First, it might not provide adequate time for the development of a mine, and the risk of forfeiting the lease might reduce the price paid for the lease. Second, it may encourage lease holders to

develop the mine prematurely, and thus, lead to inefficient long term use of coal resources. Third, it makes it more difficult for the Government to rely on market mechanisms to make tract selection decisions.

To avoid these problems, but in order to continue to achieve the objectives of the diligence standard, the Commission recommended the use of escalating advance royalties. The Commission believed these royalties create a sufficient incentive to produce without the extreme penalty of lease termination which results in forfeiture of the lessee's entire investment.

The Department agrees with the Commission's recommendation that the 10 year termination requirement be abolished and believes that it should be replaced with a system of fees, penalties, or other financial incentives to spur development of leased Federal coal resources in a timely manner. The Department will work with Congress to develop a system of incentives which protects Federal and State interests while recognizing the legitimate concerns of Federal lessees.

Recommendation VII-2

The Commission recommended that for pre-1976 leases, the lessee should begin paying advance royalties at the time of lease readjustment, and that such payments should be on the same schedule as may be paid for post-1976 leases. The Commission believed that these payments should begin 10 years after lease issuance.

The statutory 10 year produce-or-lose requirement does not apply to leases executed prior to the enactment of the FCLAA. However, pre-1976 leases are subject to readjustment every 20 years, and the Department has, through regulation, required lessees to produce coal in "commercial quantities" within 10 years of the next lease readjustment date.

The Commission contended the time period allowed for the development of commercial quantities of coal under the administrative framework is too long, and the requirements for the two classes of leases -- pre-1976 and post-1976 -- should be similar. The Commission, however, recognized that past history and legal requirements may necessitate some differences in treatment.

The Department also believes that similar types of incentives should exist for both classes of lessees. It would be extremely inequitable to require forfeiture of the lease in one situation and to apply a less drastic penalty in the other. The differences between the two classes of leases can be addressed through varying the timing of the penalty or financial incentive and the degree of escalation of any advance royalty. It would not be appropriate, however, for the Department to change the diligence requirement for pre-1976 leases until the diligence requirement for post-1976 leases is addressed by Congress.

The Department continues to take the position, advocated by the Commission in a judgment on page 304 of its Report, that section 3 of the FCLAA should be repealed. That section prohibits acquisition of any new Federal mineral leases by any company or affiliate which holds a coal lease and has not produced commercial quantities of coal within 10 years of lease issuance. This prohibition will apply to all pre-1976 lessees after August 4, 1986, and will undoubtedly depress bidding competition after that date. The total effect of the prohibition is as yet unclear, but the Department agrees with the Commission that a system of penalties or financial incentives, if adopted, will be adequate to ensure diligent development of Federal coal leases.

Recommendation VII-3

The Commission recommended that the requirement for consent of qualified surface owners before leasing should be maintained, but that in light of difficulties reported, Congress consider reexamining the need for limitations on payments for surface owner consent.

The Commission believed the surface owner consent provisions of the Surface Mining Control and Reclamation Act (SMCRA) have depressed bids for Federal coal leases and have provided windfalls to speculative purchasers. Further, it concluded these provisions have greatly complicated the tract selection process.

The Commission offered no solution, reporting only that the problems are complex and the data is poor. Hence, the Commission concluded Interior should reexamine its procedures and Congress should examine the problem to determine whether any limits on payments to current consent holders or the future signers of consents should be established.

The Department believes it should hold the reexamination of its administrative procedures in abeyance until Congress determines whether a change in the legal framework is warranted. Once Congress determines whether there is a need for it to act, the Department can better assess the need to change the administrative structure.

Recommendation VII-4

The Commission recommended the Congress consider giving the Secretary of the Interior administrative discretion to reduce Federal royalty rates for coal tracts prior to a lease sale, where current royalty rates would have adverse effects on production of the resource.

The Federal Coal Leasing Amendments Act of 1976 established a royalty of not less than 12-1/2 percent for surface mined coal. However, it provided that the Secretary may permit a royalty reduction for economic reasons only after the lease has been issued. The royalty on underground coal is left to the discretion of the Secretary.

The Commission found that in areas where Federal coal is dominant it tends to dictate the royalty rate for privately owned coal resources. Where, however,

Federal coal is not a significant portion of the market, as in Alabama and North Dakota, the 12-1/2 percent royalty can make it difficult to sell leases.

The Commission questioned the wisdom of adjusting royalty rates after a sale because the bonus bid is based on the royalty rate established prior to the sale. Hence, a reduction arguably results in a windfall for the lessee. Also, a post-sale reduction, in the Commission's opinion, would tend to bring otherwise unprofitable reserves into production sooner than the market would dictate.

The Commission concluded that discretionary reductions should be permitted on a regional basis in advance of the sale where Federal coal is not the dominant market source and the royalty rate for private coal is lower than the Federal rate, or on an individual lease basis where the tract to be leased is surrounded by non-Federal coal with a lower royalty rate. The Department agrees with the principles advocated by the Commission and would be pleased to work with Congress to implement them.

Recommendation VII-5

The Commission concluded that the base for calculating Federal royalty payments should be the F.O.B. price minus all State and local severance and similar taxes. Under the terms of most Federal and Indian mineral leases, the Department computes its royalty based on the "value" of the minerals produced. This "value" is the gross proceeds from the sale of the produced minerals, including all valuable consideration received by the lessee such as any fees and taxes which, under the terms of the sales agreement, the buyer reimburses the lessee or pays on behalf of the lessee.

This method of royalty computation is not limited to Federal coal production or to severance taxes, but extends to other Federal minerals, such as oil and gas, to other reimbursed costs such as reclamation fees and royalty payments, and to Indian minerals. Elimination of reimbursed taxes from coal value alone would create inconsistent practice with regard to other minerals and to other reimbursed costs.

In the view of the Commission, inclusion of State and local severance and similar taxes in the value of Federal coal for royalty purposes results is an inappropriate "hidden" tax on the production. The Commission believed the elimination of these taxes from the royalty valuation process will distinguish the impact of State taxes from Federal royalties on the ultimate cost of coal. Thus, each governmental entity will then be clearly responsible for its policies on revenue collection.

However, elimination of any or all reimbursed costs may create a situation of collecting royalty on less than the "value" of the production as required by the Mineral Lands Leasing Act, as amended. The Department has taken the legal position in the past that royalty on Federal leases is owed to the United States as lessor and only after the royalty is paid is the revenue distributed according to the statutory formula. Accordingly, the Department believes this issue must be addressed by Congress after a study of its effects on other programs and on State and local governments.

Recommendation VII-6

The Commission recommended that to promote greater competition in transporting Federal coal and to achieve fair market value for Federal coal, Congress should consider instituting a review to assess whether shippers of Federal coal are adequately protected from anticompetitive or discriminatory practices when slurry pipelines or other forms of transportation competition are insufficient. The Commission found that transportation costs were the "most critical factor" affecting demand for western and Federal coal. However, it reported that insufficient data was available to examine this issue sufficiently.

The transportation of coal is generally outside the Department's jurisdiction unless a right of way is issued across public land. The Department takes no position on these recommendations. Similarly, the Department takes no position on the Commission's judgment that to promote greater competition in transporting Federal coal and to achieve fair market

value for Federal coal, Congress should enact legislation giving eminent domain authority to coal slurry pipelines.

Judgment (p. 343)

The Commission determined that in order to achieve the development of Federal coal in railroad checkerboard areas, Congress should amend section 2(c) of the Mineral Lands Leasing Act to allow a railroad company or its affiliate to bid for Federal coal leases within its land grant area only if: (1) it releases its exploration data on its own coal holdings within the land grant for Federal tracts that will be part of the same logical mining unit, and (2) the railroad or its affiliate agrees to participate in cooperative leasing of railroad and Federal coal.

Section 2(c) of the Mineral Lands Leasing Act prohibits the acquisition of Federal coal leases by railroads or their affiliates. However, as a result of the 19th Century railroad right of way grants, railroads own large amounts of coal interspersed with Federal coal ("checkerboards"). In most cases, this interspersed coal must be combined into logical mining units if it is to be attractive to potential developers.

The Commission believed the protections afforded by this section are no longer required because railroads do not have the economic power that they had at the time this section was enacted. The Commission concluded the amendment of section 2(c) would "unlock" the Federal tracts within the railroad checkerboards and might increase competition if linked with a measure to ensure equal access to the coal, and if the railroads were required to disclose information on the coal characteristics and other features of the tracts owned by the railroads.

The Department supports the amendment of section 2(c). The antitrust review procedures contained in section 15 of the Federal Coal Leasing Amendments Act of 1976 should protect against monopolization of the coal industry by the railroads. The conditions suggested by the Commissioners would reinforce these

protection benefits in the checkerboard areas. Amending section 2(c) would improve the Department's ability to manage Federal coal resources in checkerboard areas and would increase the number of potential competitors for Federal coal leases.

ORGANIZATION AND MANAGEMENT

The Commission alleged that due to a number of historical factors the coal program had not received quality management. It pointed out the responsibility for the program had been fragmented and had been transferred frequently to various units within the Department. Further, the Commission believed the Department had placed its primary emphasis on other programs and had not developed the type of management structure most appropriate for the coal program. Accordingly, the Commission made five recommendations to improve the quality of the program's management.

The Department concurs with the recommendations. It has made progress on these issues including preparations for the formation of a centralized policy and analytical guidance group and has stressed the need for field office evaluation capability. The Department will take additional steps within its authority to implement the recommendations.

Recommendation VIII-1

The Commission recommended that delineation teams should include an economic analysis capability. The Department concurs with this recommendation and recognizes the need to enhance its economic analysis capabilities to allow it to assess more effectively the economic factors affecting competition in tract delineation. Accordingly, the Bureau of Land Management is fully integrating the evaluation expertise gained through merger with parts of the Minerals Management Service and will complete the process of strengthening this capability by June 30, 1984.

Recommendation VIII-2

The Commission recommended the Bureau of Land Management economic appraisal function be organized with a centralized coordinating group for policy and analytic guidance, and with regional rather than State teams for implementation.

Policy development and guidance procedures will be placed in a centralized coordinating group in the Washington office. Planning for the formation of this group began in FY 1983 and the group is now operational. This group will have as one of its first tasks the primary responsibility for developing the uniform appraisal policies and methods recommended by the Commission (see Recommendation VIII-3). Further, the Bureau of Land Management is realigning the Washington office to emphasize economic analysis functions.

Regional evaluation teams have been adopted previously for coal leasing. By August 31, 1984, the Bureau will develop an organizational chart, position descriptions, delegations of authority, and regional team office functions. In addition, the appropriate budget and staffing revisions will be made.

Recommendation VIII-3

The Bureau of Land Management centralized coordinating group for economic evaluation should develop and validate a uniform appraisal method. The Department concurs with this recommendation.

The Bureau of Land Management has been striving to develop and implement a uniform appraisal methodology and has already solicited outside expertise. The most recent coal appraisal procedures have been reviewed by the Colorado School of Mines which judged them to be reasonable and consistent with industry practice. The Department recognizes the dynamic nature of the appraisal process, and the Washington office responsible for economic evaluation will continue to focus on and refine appraisal techniques.

As stated previously, the Bureau of Land Management has been directed to compile a uniform appraisal method in a single document by September 1, 1984, at which time it will be made available for public comment. The procedures will be implemented Bureau-wide.

Recommendation VIII-4

The Commission recommended that the Bureau of Land Management's sales panels which make bid acceptance or rejection recommendations, should be constituted so as to assure the presence on those panels of persons with the background and capabilities of making judgments with respect to appraised values.

The Department agrees with this recommendation and is taking steps to implement it through representation on and support of the panels by personnel with this capability. The Bureau of Land Management sales panels are composed of Departmental employees. Pre-sale appraisals are reviewed for reasonableness as well as compliance with established Bureau procedures. The panel also will examine whether the process was appropriately followed and will assess whether fair market value was received.

Also, there is currently the opportunity for an ex officio representative of the appropriate State Governor(s) to serve on the panels. At least one member of the pre-sale economic evaluation group serves on the panels. This participation, however, has not been mandatory.

The Department will publish the qualifications required for panel membership by June 15, 1984. Mandatory participation by the following individuals will be considered:

1. an ex officio State representative with appraisal background;
2. a member(s) of an economic evaluation team from a different region;
3. a Departmental representative from the Washington Office; and
4. a Deputy State Director for Minerals.

Recommendation VIII-5

The Commission recommended that the Inspector General be directed to conduct periodic audits of the Federal Coal Leasing Program, and that necessary expertise should be obtained from the private sector where appropriate. The Department concurs with this recommendation and will request that the Inspector General conduct periodic audits of this program.

Further, the Department will work toward integrating oversight functions into internal program management under the Office of Management and Budget (OMB) Directive A-123 and the Federal Manager's Financial Integrity Act. For this purpose, outside contractors also will be utilized whenever necessary to furnish expertise unavailable within the Government.

CONCLUSIONS

The Department appreciates the effort the Commission put forth in addressing the complex issues involved in Federal coal leasing. As detailed in the paper, the Department has fully incorporated the Commission's findings into this review of the program and proposes to adopt all but one of the Commission's recommendations, which are within the Department's authority to implement. Once public review of the Department's plans is completed, the appropriate Congressional committees consulted, and final plans adopted, the Department believes it will be able to implement a coal leasing program that promotes the national interest.

ATTACHMENTS



ATTACHMENT I

IN REPLY REFER TO:

United States Department of the Interior 2200 (321)

BUREAU OF LAND MANAGEMENT
WASHINGTON, D.C. 20240

November 1, 1983

Instruction Memorandum No. 84-81
Expires: 9/30/84

To: AFO's

From: Director

Subject: Land Exchange Policy

Enclosed for your use are two policy statements for fee exchanges that were approved by the Assistant Secretary on October 14, 1983. The first statement is concerned with general fee exchange policy. The second statement is limited to fee exchange of leasable and salable minerals.

The two policy statements will eventually become a part of the BLM Manual Section 2200.

Deputy Director, Lands and Renewable Resources

2 Enclosures

- Encl. 1 - Fee Exchange Policy (General) dated 9/26/83 (2 pp)
- Encl. 2 - Fee Exchange Policy for Leasable and Salable Minerals dated 9/26/83 (1 p)

BUREAU OF LAND MANAGEMENT
FEE EXCHANGE POLICY (GENERAL)

This statement sets forth general BLM policy for the exchange of public lands or interests therein. It reflects the provisions of Sections 102, 205, and 206 of the Federal Land Policy and Management Act of 1976 (90 Stat. 2744 and 2755-56; 43 U.S.C. 1701 and 1715-16), hereafter FLPMA. This policy statement represents a commitment by BLM to implement the land exchange policies of the FLPMA, consistent with BLM's other statutory obligations.

The BLM recognizes that numerous opportunities exist for public interest land exchanges with the non-Federal sector. BLM has a responsibility to work closely with other Federal resource management agencies, State and local governments, and the private sector to complete these mutually beneficial transactions. Benefits to be derived for the Federal and non-Federal sectors include elimination of inholdings, better management areas, and greater economic returns for all concerned.

The following principles shall guide BLM in its land exchange program:

1. Disposal of public lands by exchange shall be considered as serving the national interest within the policy context of Section 102(a)(1) of FLPMA.
2. The BLM shall strive to process mutually benefiting, public interest, land exchanges in a timely and efficient manner through continually maintaining and streamlining its land use planning, appraisal, and exchange processes.
3. Exchanges to acquire inholdings in Federal conservation areas are in the public interest and will aid in the reduction of the national debt through reducing expenditures of appropriated funds in the acquisition of lands or interests in lands needed for Federal conservation purposes.
4. Acquisition, through exchange rather than purchase, of lands or interests in lands required for Federal resource management or protection programs will retard the present expansion of Federal real estate holdings and help to assure the integrity of State and local tax bases.
5. Comments from affected States, local government, and the general public shall be sought and considered before completion of each exchange.
6. Exchanges may be utilized, when economically advantageous, to consolidate attractive parcels for sale.
7. Patent and deed reservations and conditions shall be kept to the absolute minimum necessary to complete the transaction. Rights of third parties holdings rights-of-way and other legal interests in the exchanged lands shall be protected.
8. The generally preferred rule is for both surface and subsurface (mineral) estates to be traded in an exchange. However, due to third party encumbrances, or difficulties in the valuation process, it may be preferable to complete certain exchanges with reservations. Such exceptions to the generally preferred rule are to be made on a case-by-case basis.
9. Exchanges shall be utilized to consolidate or unite the surface and subsurface estates for both the Federal Government and non-Federal owners in split or mixed estate situations.
10. Exchanges may be utilized to effect ownership and management area boundary changes or adjustments and to form more logical and efficient land and resource management areas for both the Federal Government and non-Federal owners.

11. In application of the determinations of public interest required under Section 206(a) of FLPMA, the BLM shall give the broadest possible consideration of public needs when evaluating exchange proposals.

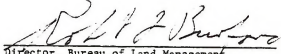
12. Whenever the law permits, expenses incurred by BLM on exchange actions for the benefit of other Federal agencies shall be recovered from such benefiting agency. The BLM shall not attempt to recover nominal costs.

13. Mining claims of record shall only be contested for the purpose of determining the validity of such claims in those instances in which an exchange has been determined to be in the public interest. Expenditures of limited Federal appropriations will not be made simply to clear the land of mining claims of one party to make the land available for another party.

14. When an exchange involves the cancellation of a grazing permit or lease, the compensation for range improvements and two-year notification requirements of Section 402(g) of the FLPMA and 43 CFR 4110 shall be met.

15. The Bureau shall maintain effective professional, technical, and managerial personnel in the disciplines necessary to complete exchanges of all types.

These principles shall be implemented and further clarified where necessary through specific guidance to the field.


Director, Bureau of Land Management

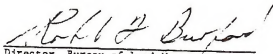
9/26/83
Date

Bureau of Land Management
Fee Exchange Policy for Leasable
and Salable Minerals

The exchange of leasable and salable minerals is an important tool in achieving public interest Federal multiple use management and land protection goals. When considering an exchange, the manager must also consider the relative utility of competitive and cooperative leasing of leasable minerals, and sale of salable minerals, in their pre-exchange configuration. Although all of the following policy elements will seldom, if ever, be found in any one exchange proposal, one or more should be found in every proposal. Any proposal that would have an opposite effect to a policy element contained herein would not be considered to be in the public interest and must be denied at the earliest possible stage.

An exchange of minerals is in the public interest if:

1. The exchange would consolidate Federal holdings into a logical mining unit(s).
2. The exchange would consolidate non-Federal holdings into a logical mining unit(s).
3. The exchange would serve a national resource management or protection need.
4. The exchange would simplify jurisdiction and allow Federal land use planning efforts to be confined to an area in which the United States controls the mineral development.
5. The exchange would reunite Federal surface and subsurface estates.
6. The exchange would eliminate isolated tracts and checkerboard patterns of Federal minerals.
7. The exchange would achieve a management goal without using appropriated funds to pay for the resources needed by the United States.
8. The exchange would meet needs of State and local people.
9. The non-Federal lands to be received in the exchange would serve the public better in public ownership than the minerals to be transferred in the exchange.
10. The exchange would enhance competitive bidding for the Federal minerals.
11. The potential revenue from a lease or sale of the Federal minerals consolidated by the exchange would be greater than the potential revenue from a lease or sale of the minerals in Federal ownership prior to the exchange.
12. The exchange does not involve a transfer of a fee interest in Federal minerals for a less than fee interest (e.g., conservation or scenic easements) in non-Federal lands. If a less than fee interest in non-Federal lands is all that is needed, a fee exchange shall be followed by a competitive bidding, or a modified competitive bidding, sale of the unneeded interests as the situation dictates.



Director, Bureau of Land Management

Date

9/26/83



United States Department of the Interior

BUREAU OF LAND MANAGEMENT
WASHINGTON, D.C. 20240

July 26, 1983

Instruction Memorandum No. 83-734
Expires 9/30/84

To: State Director, Montana

From: Director

Subject: Lease Sale Procedures to be Used in the 1983 Fort Union Coal
Lease Sale

The Department is considering offering for lease Federal coal tracts in the Fort Union Region for development and production of coal. In support of that possible sale, the Bureau of Land Management (BLM) has developed a methodology for analysis of bids on leases which may be offered.

The following steps are to be your basic operational procedures.

A. Presale Procedures

The Department has established a minimum bid of \$100 per acre for all tracts. This minimum bid is not to be considered as representing the amount for which the tracts may actually be leased, since fair market value (FMV) will be determined in a separate post sale analysis. The purpose of the minimum bid is only to help ensure that potential bidders have the financial ability and good faith to develop the tracts per the lease requirements. This minimum bid shall be posted in the State Office and published in the Federal Register Notice of Sale 30 days before the sale.

Prior to the sale an evaluation team will be designated by the State Director to appraise the tracts, both presale and post sale based on the "Uniform Appraisal Standards for Federal Land Acquisitions." The State Director will also designate a sale panel to receive the appraisal report as shown in the enclosed flow chart units A through F.

The preferred method for deriving presale appraised values is to take prices paid for comparable tracts and adjust them to simulate the value and characteristics of each of the offered tracts. Discounted cash flow (DCF) models can be used for such adjustments to reflect cost and revenue differences in a representative tract and mine development implied by the tract characteristics. The DCF model adjustments are used when the many comparables needed to isolate the market impact of each of the tract characteristics are not available. In either case the value is still based on comparable sales. In an enclosure to this Instruction Memorandum the procedures for selecting and adjusting presale comparables are explained and the presale appraisal is shown in the enclosed flow chart unit G.

Generally, in order for a past sale to be considered "eligible" as a comparable based on the "Uniform Appraisal Standards ...", the sale must have a willing knowledgeable buyer and seller with neither under duress. Then the selection of a single comparable or a bracket of two comparables from those eligible is based on proximity in time, location and physical characteristics as explained in the enclosed comparable sales guidelines. A tract thus selected is defined as "selectable" for the offered tract involved.

When comparable sales data are nonexistent or not good enough to be used as a basis for simulating the offered tract and implied mine unit, a DCF model can be run. The DCF model simulates the revenue and cost flows of a representative development project for each tract and its prospective new mine unit to derive its net present value. This net present value prorated from its prospective mine unit, is an estimate of the surplus above all costs (including return on capital) available to a lessee of each tract under the particular simulation run.

Although a single value can be used in appraising a tract lease value, the best estimate of a tract value can often be made by calculating the mean of multiple DCF estimates representing alternative outcomes of the tract activity for the lessee. Without good information on the distribution of these estimates they should be treated as equally likely. Their unweighted average is called a mean range of values (MROV). This MROV can function as the presale appraised value for each tract, provided it is checked and adjusted to allow for rational decisionmaking by the simulated developer. The MROV approach with multiple equally likely outcomes assures that the appraised value in the DCF case takes into account the large range of outcomes which may occur for the lessee. These outcomes include those cases where no development occurs and also where development occurs but losses are sustained.

The specific presale appraisal steps mentioned above and their required documentation are highlighted below as follows:

- Step 1 - Look for "eligible" and "selectable" past comparable lease sale values (as explained above and in the comparable sales guidelines enclosed) for each offered tract.
- Step 2 - If "eligible" and "selectable" presale comparable past lease sale values (as explained in the enclosure) are available, adjust them through a DCF model (revenues and costs) or by the comparison of comparables technique to simulate the value implied by the characteristics of the offered tract. If more than one equally good comparable is available then two comparables may be selected to bracket the offered tract and averaged to yield an appraised value.

- Step 3 - If "eligible" and "selectable" (for a particular offered tract) sales are not available, use a DCF technique to derive net present values under alternative future cost and price scenarios for a representative mine unit project. To do this, obtain estimates of future product prices and ranges. Also obtain engineering estimates of future project costs and ranges.
- Step 4 - Adjust the net present values generated by the alternative (assumed equally likely) scenarios simulated by the DCF to reflect rational decisionmaking and foresight by the developer.
- Step 5 - Take the unweighted MROV of the alternative DCF outcomes simulated for each tract and use this as the appraised value of the tract.
- Step 6 - Write a presale appraisal report which cites in detail the data sources, methods, assumptions, and conclusions used for deriving each single appraised value. Have it signed, dated and sealed by the evaluation team and delivered in final form to the State Director prior to the sale. This report is to be treated as highly confidential material and is not to be opened or released to anyone prior to the sale.

B. Sale Procedures

A Notice of Sale will be published in the Federal Register at least 30 days before the sale. The Notice of Sale will include the qualifications for a bid to be considered and the details of the actual sale procedure.

The place, date, and time of the sale will be provided to potential bidders in the Notice of Sale as well as provisions for entering bids prior to the sale. This process is shown in enclosed flow chart items B, H and I. Moreover, the BLM's requirement of a sealed bid not followed by oral auction will be explained as well as the BLM assurance, prior to the announcement of bids, to treat bidder identities and dollars bid as confidential.

The Notice of Sale will explain that for any bid to qualify for consideration by the BLM in the lease(s) sale it must meet these criteria: (1) it must meet or exceed the minimum bid published in the Notice of Sale, and (2) the bidder must pass all the qualification requirements of the 43 CFR 3400 rules. It should be emphasized that qualification of bids has no relation to the final BLM decision to accept or reject bids based on FMV concerns. It only qualifies the bid for further consideration.

Finally, the State Director in carrying out the sale is responsible for ensuring the confidentiality of the identity and the number of the bidders prior to the conclusion of the sale. Moreover, he is responsible during the presale, sale and post sale periods for assuring the confidentiality of the presale appraisal and the appraisal report until such time as he is authorized to release them.

C. Post Sale Procedures

The sale panel will screen all bids received to determine if they are qualified for consideration (see flow chart unit J). For a bid to qualify for consideration the sale panel must determine that: (1) the bid meets or exceeds the minimum bid; (2) the bidder passes all the qualification requirements of the 43 CFR 3400 rules; and (3) there is no indication of collusion in the bidding on the tract(s). If there is an indication of collusion, or of compromised presale confidentiality, the sale panel should advise the State Director who will notify the Inspector General and other appropriate Washington Directorates.

The evaluation team will write a post sale appraisal report describing its new appraisal (if any) of each tract value based on the sale results. It will do this for tracts with qualified high bids (see flow chart unit K). All tracts receiving qualified bids will be examined to isolate those tracts which BLM can use as postsale comparables. The tracts, if any, to be used as post sale comparables to evaluate other tracts are required to have the following four characteristics in addition to having qualified high bids.

- Step 1 - At least two countable bids must have been received for the tract, and any bid less than 1/4 of the presale appraisal must be excluded from the count.
- Step 2 - The high bid must be equal to or greater than the average of the presale appraisal and the two or more countable bids submitted (using the 1/4 rule above) on the tract. This average is called the "Average Evaluation of Tract (AETOT)."
- Step 3 - The tract must be of a nature where it is "eligible" based on the comparable sale selection procedures in the presale section above and the enclosed comparable sale guidelines.
- Step 4 - The tract must be "selectable" based on the comparable sale selection procedures in the presale section (above) and the enclosed guidelines.

If these four conditions are satisfied then that tract's high bid can be used in a new post sale appraisal of an appropriate remaining tract(s) with a high qualified bid. This means that the tract is a potential candidate for use as a post sale comparable to use in evaluating remaining tract(s). This postsale appraisal (if any) shall follow the presale appraisal procedures described above and the comparable sale guidelines enclosure.

A complete and fully documented post sale appraisal report (if one is required) shall be added to the presale appraisal report above, and submitted to the sale panel. The post sale appraisal values given to the sale panel in the report shall be the Average Evaluation of Tract (AEOT) for those tracts found "eligible" in steps one, two and three above. Post sale appraisals of the remaining tracts will be based on post sale comparables, where available, which are both "eligible" and "selected" in steps one, two, three and four above.

The sale panel will then review the high qualified bids and closely examine the evaluation team report, to review its assumptions and methods. The high qualified bids on each tract will then be compared to the appraised value of the tract contained in the post sale report (to the extent available) or the presale report of the evaluation team. If the sale panel is satisfied with the report involved, the panel will then recommend the acceptance or rejection of each qualified high bid to the State Director based on these appraised values and explain the recommendation (see flow chart unit L).

The State Director will review the sale panel's recommendation(s) concerning the tract(s) with high qualified bids as well as the sale panel's explanation for its recommendation. The State Director will then decide on the basis of these considerations if any qualified bid(s) represent FMV and accept or reject qualified bids accordingly.

If a bid is accepted in post sale deliberations, the appraisal value will become part of the public record. If no bid is accepted, all appraisal information on that tract will be kept confidential (see flow chart unit M).

Finally, the above is designed as guidance for the 1983 lease sale, but modifications may be necessary and may be incorporated as appropriate after the approval by the State Director. Any such modifications require documentation as part of the lease sale record. In any event, all activities undertaken must reflect thoughtful analysis applicable to each unique offered tract and professional methods and judgment.

Complete documentation of the decision activities must be kept available for immediate access. Moreover, these decision processes should be replicable from the written reports and memoranda available and any variation from consistent application from case-to-case should be fully explained (see flow chart unit O). Any procedural questions should be directed to the Washington Office, Attention: Erick Kaarlela, Chief, Office of Resource Evaluation and Program Development, (641), FTS 343-4537.

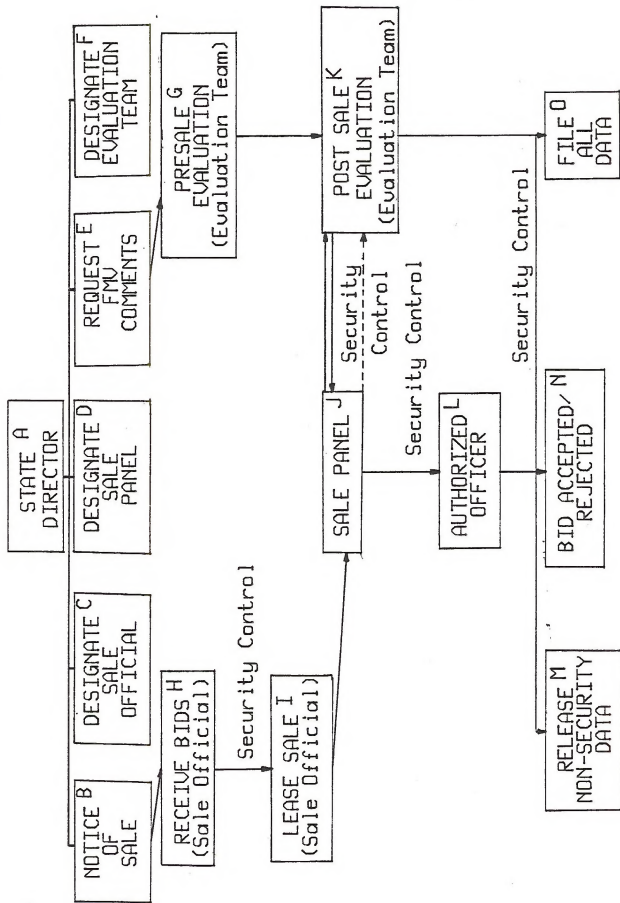


2 Enclosures (to addressee only):

Encl. 1 - Flow Chart (1 pp)

Encl. 2 - Comparable Sale Guidelines (4 pp)

FLOW CHART



Comparable Sales (Market Data) Guidelines

The basic standards for estimating fair market value (FMV) are set forth in the "Uniform Appraisal Standards for Federal Land Acquisitions." The following is provided for clarification as to how those standards are applicable to the comparable sales approach used in coal lease sale evaluation. Three main concerns are addressed:

1. How to determine that a transaction involving a disposal of a coal property is eligible to be considered for use as a comparable?
2. What factors are to be considered as rating elements in making comparable sales appraisals?
3. How to determine which transactions are most comparable based on the factors, and therefore, selectable to be used in the appraisal?

1. Eligible Transactions

For evaluation of minerals on Federal lands, the best sources of information are prior Federal competitive lease sales. Sales by State agencies and Indian Tribes are also a good source of information. For such sales the terms and usually the motivating forces are readily obtainable. Private sales are useful if sufficient data can be found to verify the prices, terms and the nature of the sale. Even when the sale is recorded in the county courthouse, the sale is not considered reliable unless either the buyer or seller (preferably both) are contacted and the terms of the transaction verified. Qualify the prices as to terms, motivating forces, and bona fide nature of the sale. If the transaction was at arms-length, both buyer and seller were knowledgeable, the buyer was not under pressure to buy and the seller was not under pressure to sell, the tract is eligible to be considered as a comparable.

2. Factors to Consider

In searching for possible qualifying coal market transactions, the appraiser should restrict his record to (1) transactions in certain years; and (2) a certain geographic area. Although the time and general location have been considered, the tract cannot be considered a selectable until the physical and economic similarities and dissimilarities (rating elements) have been evaluated. If the dissimilarity between the tracts is too great, the tract cannot be considered a comparable. The "Uniform Appraisal Standards for Federal Land Acquisition" list six general rating elements to be considered.

Some of the more important specific factors to be considered in evaluating coal leases are listed below. No list can cover all possible factors for which a monetary adjustment might be required. Many of the listed factors may not require a monetary adjustment for each comparable tract even though there are slight differences between the subject and the comparable tract. Except under very unusual circumstances the basis for comparison should be tons of recoverable coal.

Factors for Comparison

(1) Time of Sale and Market Conditions

Market conditions change over time so the more recent the comparable sale the better. In general if market conditions have changed significantly the tract should not be used as a comparable.

(2) Terms of Sale

Fair market value normally is stated in terms of cash or its equivalent payable at the time of sale. The bonus payable for Federal coal leases is paid in five installments. Private comparable lease sales may have different terms for paying the bonus. This would require an adjustment but would not be difficult. If the royalty rate were different or the private tract was sold in fee, the adjustment is much more difficult and the sale might not be suitable for a comparable.

(3) Stripping Ratio

This is a major factor and will require adjustment if there is much difference between the subject and comparable tract as the stripping ratio greatly influences the costs of coal production.

(4) BTU Content Of Coal

The value of the coal increases with the BTU content but small differences in BTU content may not warrant price adjustments. Examination of coal purchase contracts between mines and utilities will give an indication of the monetary adjustment if one is needed.

(5) Other Qualities of Coal

The sulfur content of the coal should be considered. In some regions fairly small differences in sulfur content greatly affect the salability of the coal and hence the value of the lease. A high ash content is undesirable but as ash content tends to vary inversely with BTU content, an adjustment is not usually made for the ash. It should be considered, however. Certain coals contain very deleterious elements such as sodium that greatly affect the marketability of the coal and may require a monetary adjustment.

(6) Time and Rate of Production

The time of and rate of production affect the value of the coal since greater production and production at an earlier time means greater revenue and at an earlier date. Adjustments must be made to indicate the value of money and as the result of economics of scale and efficiencies.

(7) Access to Lease and Transportation

This factor would include obtaining surface owner consent and possibly a right-of-way. Transportation from the mine to a railroad or to a power plant is an important factor and an adjustment should be made if there is a considerable difference between the comparable and the subject tract. Only if there is clear evidence that the coal from the comparable and the subject tract will be sold for consumption at different locations, should consideration be given to making an adjustment for rail shipment costs. For example if a tract had been sold to supply a mine mouth electrical utility, it would be reasonable to believe that the lease would fetch a little more than a lease not so favorably located.

(8) Coal Market

Although most coal is consumed by domestic electric utilities, there are other major uses, for example metallurgical coke. In adjusting comparable to the subject tract, consideration should be given to the probable market for the coal if there is a difference. In some cases coal obviously designated for a different market may not be a suitable comparable.

(9) Reclamation Costs

There may be significant differences in the land reclamation costs per ton of coal produced. An indication of this difference between the comparable and the subject tract is the recoverable tons per coal acre. (The coal acres may be considerably less than the total acreage in the lease). Even though the reclamation costs may be significantly different the effect on the FMV of the bonus may be relatively small because the cost will be incurred in the future. In addition any unusual difficulties or requirements regarding reclamation should be considered.

(10) Other Factors

Any other difference between the comparable and the subject tract that a reasonable person would consider important should be analyzed and a monetary adjustment made if warranted.

Geologic factors might be that one tract contained hard beds that required blasting or that in one tract the coal contained numerous shale seams so that the coal would require washing in order to be saleable. If the tracts were in different states that had significantly different laws affecting profitability of a mine, an adjustment might be warranted.

3. Selectable Transaction

It must be determined whether an eligible tract is selectable as a comparable for each offered tract. Thus an eligible tract might be a suitable comparable for offered Tract A but not suitable for Tracts B and C. The importance of the various factors will vary from region to region. For example, sulfur content in general is not a major factor in the Fort Union Region but is very important in the East.

The greater the difference of a particular element between the eligible and the offered tract, the less reliable the eligible tract. Some factors, however, are much less important than others so that even a large difference would require only a small monetary adjustment. However, there could be differences between the tracts that require significant monetary adjustments, but if the amount of the adjustment can be determined with a high degree of confidence, the eligible tract can be considered reliable. For example, if the offered tract requires the relocation of a major power line or the construction of 20 miles of haulage roads across adjacent lands and the eligible tract does not, the required monetary adjustment most likely could be determined with a high degree of confidence. On the other hand, there may be differences in tract attributes for which it would be extremely difficult to make reliable monetary adjustments so that they generally should not be used as comparables. If there are major problems related to landownership (both surface and subsurface) it might be difficult to make a reliable adjustment. Encumbrances that affect value are difficult to adjust for and may make an apparent comparable unsuitable.

Before determining if a candidate tract is suitable for use as a comparable, the appraiser should prepare a list of elements that should be considered. The most critical elements should be listed first. This list should be applicable to all tracts. Then on a tract-by-tract basis, each factor should be considered in view of how critical is the factor, what is the difference in the factor between the two tracts, and how reliable is the adjustment. Thus, a very critical factor might not be very important if the difference is small. The appraiser may develop a weighting system for each factor to use as a guide to determine the general comparability of tracts.



United States Department of the Interior

BUREAU OF LAND MANAGEMENT
WASHINGTON, D.C. 20240

August 24, 1983

Instruction Memorandum No. 83-794
Expires 9/30/84

To: All State Directors

From: Director

Subject: Security of Confidential Data Pertaining to Federal Coal
Lease Sales

The confidentiality of coal lease sale information is discussed in 43 CFR 2.20 headed: Special rules governing certain information concerning coal obtained under the Mineral Leasing Act. The regulations, which appear with Freedom of Information Act regulations, describe some of the kinds of coal information to which confidential status is applicable and if, how and when that information will be made available.

These regulations clearly permit the Bureau of Land Management (BLM) to prohibit the release of the estimated fair market value (FMV) of coal lease tracts until the decision has been made to issue a lease. The BLM is also permitted under these regulations to withhold information pertaining to bids submitted for tracts prior to a lease sale.

Disclosure of estimated FMV and bids received can jeopardize lease sales of highly significant economic value and it is therefore imperative that these figures be protected from premature release to the public. To ensure security of this information, the following procedures are to be implemented:

Procedures

The following shall be specific requirements for the handling of sensitive data pertaining to Federal coal lease sales.

1. Pre-sale Estimates and Proprietary Data

The pre-sale estimate of FMV plus any proprietary data used in the determination of this FMV must be properly safeguarded. Only those persons with a "need to know" shall have access to the sensitive data.

- The data shall not be discussed outside of the official BLM meetings and shall not be discussed over the phone.
- Meetings where the data are discussed shall be held in a secure office and in such a manner that non-BLM personnel and BLM personnel without a need to know are prohibited from having access to confidential data.

- All confidential data shall be locked in a secure government approved filing cabinet or vault when the data are not actually required for analysis and discussion purposes.
- All draft and final typed reports relating to FMV pre-sale estimates shall be treated as confidential information.
- The typist shall be instructed not to reveal any confidential data, and how to handle all typed material on FMV.
- Only one person, a professional level BLM employee, shall have a key to the vault where the confidential data are stored.

2. Bidding Information

After a coal lease sale is announced, extreme caution must be exercised in the treatment of bids submitted. Fail-safe procedures must be in place to avoid disclosure of any information pertaining to: total number of bids received, number of bids per tract, identity of bidders, the tracts for which bids were received, and the amount bid for any tract or all tracts. Bids are to be hand-delivered or sent by registered mail to the appropriate BLM State Office. A receipt will be given for hand-delivered bids upon arrival of a bid in the BLM State Office; the bid envelope shall be time and date stamped, logged in, placed unopened inside a plain envelope so as to conceal the identity of the bidder and the tract bid on, and placed in a locked vault until the date of the sale. The bids are not to be discussed verbally or in writing within or outside BLM prior to the lease sale. Extraordinary efforts must be made to prevent the release of information pertaining to the number of bids, amounts bid, identity of bidders, and tracts bid on, prior to the lease sale.

3. Post-Sale Evaluation

All post-sale appraisals and reports as well as all pre-sale appraisals and reports, along with other proprietary data, must be treated as confidential and held secure during the post-sale bid evaluation process. When bid acceptance/rejection decisions have been reached by the State Director, only the estimated value of tracts accepted shall be made available to the public upon request.

Enforcement

The State Director is responsible for the enforcement of efforts to maintain the security of all sensitive data and bids. The State Director shall request notification by any BLM employee who has knowledge of or reason to believe that sensitive data or bid information have been released either accidentally or deliberately. The State Director will notify the Inspector General of the DOI and the Director of any unauthorized release of sensitive information.


Associate Director

ATTACHMENT IV

Summary of Final Report on

THE RELATIONSHIP BETWEEN STRIPPING RATIO AND PRODUCTION RATE IN SURFACE COAL MINES OF THE POWDER RIVER BASIN AND GREEN RIVER-HAMS FORK REGION

Donald W. Jones, Edward L. Hillsman, Russell Lee, Cheryl E. Bandy-Foust and Rose S. Weaver.
Energy Division, Oak Ridge National Laboratory, February 27, 1984

In an examination of BLM's fair market valuation procedure following April 1982 sales of federal coal leases in the Powder River Basin, GAO criticized BLM's separate adjustments for annual production rate and stripping ratio as redundant, on grounds that they are highly correlated. To answer the criticism knowledgeably, BLM asked ORNL to determine the relationship between production rate and stripping ratio in the Powder River Basin and the Green River-Hams Fork Region.

Considered separately, Powder River Basin and Green River-Hams Fork surface coal mines exhibit correlations between stripping ratio and annual production which are not significantly different from zero. For the pooled sample of both regions, a negative correlation between stripping ratio and production exists, but appears to be a statistical artifact not representative of underlying geological or economic relationships.

The value of a coal lease is based on the amount and extraction cost of coal which can be mined from it. Annual production rate represents the contribution of one year's production to lease value, and stripping ratio represents a potential source of cost differentials among leases. However, a number of human controlled inputs in mining--labor, equipment, energy--also affect coal production costs. To assess differences in mining costs across leases, and to properly attribute them to their causes, these other inputs must be accounted for. With this motivation ORNL has conducted preliminary work on lease value assessment with multiple regression analysis of production rate on manhours, stripping ratio and remaining reserves. Present results tentatively identify statistically significant differences in production/cost relationships between Powder River Basin and Green River-Hams Fork mines, thus calling into question the GAO's general inferences about all U.S. surface coal mines which were derived from their results of a single, national production function. Reference to theory, and our empirical identification of independent contributions to production of coal reserves in the ground and labor inputs, also suggest that omission of reserves in the ground, as well as of energy inputs, from GAO's production function make their conclusion of no increasing returns to scale in surface coal mining unwarranted on the basis of their evidence.

Two major conclusions stand out: (1) GAO's contention that stripping ratio and production rate are so closely correlated as to render separate adjustments redundant is unsupported empirically in the Powder River Basin and Green River-Hams Fork surface coal mines. (2) Conceptually, separate accountings should be made for production rate and stripping ratio, as well as for other tract features which affect mining cost, for proper valuation of a coal lease. Empirical evidence in support of this notion is that both stripping ratio and remaining reserves on a lease are found to make independent contributions to annual production. Consequently, when valuing a currently undeveloped tract, for which annual productions are unobservable and reserves must be used as a surrogate, cost-modifying tract characteristics such as stripping ratio must be used in conjunction with the surrogate for potential annual output.

